SEP 29 1956
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

October Term, 1956

No. 468

GEORGE R. CARR,

Petitioner,

vs.

BEVERLY HILLS CORPORATION, a corporation; JOHN P. LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWNE, ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS J. FERRAR,

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Your petitioner, George R. Carr, plaintiff below, prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above entitled case on May 23, 1956; rehearing denied July 30, 1956. The opinion of the Court of Appeals (No. 14349) is not yet reported, it is printed in Appendix B hereto. The opinion is consistent in error in following similar decisions in *Smith v. Sperling* (D. C. Cal. 1953), 117 Fed. Supp. 781, and the opinion of the United States Court of Appeals for the Ninth Circuit, affirming that decision (No. 14,334, not yet reported) which is presently pending before this Court on Petition for Certiorari, October term, 1956.

Jurisdiction.

The judgment of the United States Court of Appeals for the Ninth Circuit was dated and was entered on May 23, 1956 [R. 283, 289], affirming the judgment of the United States District Court for the Southern District of California. A Petition for Rehearing was filed by petitioner within the time allowed therefor and was denied by Order dated July 30, 1956 [R. 290].

The jurisdiction of this court is invoked under the provisions of Title 28, United States Code, Section 1254(1), 62 Stat. 928.

Questions Presented.

Whether or not the jurisdiction of the United States District Court properly invoked in a stockholders suit between parties who are citizens of different states, may be destroyed by the court in realigning the corporate defendant as a plaintiff even though the complaint complied with the allegations required of rule, where it clearly appears that such defendant corporation unites with other defendants in resisting plaintiff's claim of illegality and fraud, after a demand had been made to bring suit, and the District Court found that such demand would have been futile, if made.

Statutes Involved

The statutory provisions involved are Title 28, United States Code, Section 1332(a)(1), and Rule 23(b), Federal Rules of Criminal Procedure. They are printed in the Appendix A, *infra*.

Statement of the Case.

George R. Carr, an Illinois citizen and stockholder of Beverly Hills Corporation, a California corporation, sued in the United States District Court for the Southern District of California in a stockholders derivative action. Named as defendants in the suit were the California corporation, and various California citizens, who, as officers directors, dominated and controlled the corporation at the time of the happening of the matters complained of, and at the time the instant complaint was prepared for filing. No personal liability was asserted against any individuals, other than the individual defendants who as alleged wrongdoers were officers and directors of the respondent corporation, and as such not only prevented said corporation from seeking relief in its own behalf, but united with the individual defendants in opposing this suit.

The basis for federal jurisdiction in the court of first instance was diversity of citizenship and the amount in controversy [R. 2-3].

Respondent Beverly Hills Corporation was organized in early 1949 for the purpose of acquiring various valuable parcels of real estate in Beverly Hills, California, and constructing on a part of that real estate a modern, fully equipped building of great value designed to house an integrated medical clinic, and of leasing a portion of that building to a partnership of doctors for use as a medical clinic [R. 5-6, 223]; the corporation also planned to construct, equip and operate for profit, within said building other facilities, *i. e.*, an X-ray laboratory, a clinical laboratory, and a pharmacy and soda fountain; to construct a paved parking lot on the unoccupied portion of its real estate, adjoining the building, and to operate that parking lot for profit [R. 6-7, 33, 145, 148, 173-174,

179-181, 203, 223-224, 228, 230]. The income of the corporation would thus be made up of the rent to be received from the lease of the clinic portion of the building and the profits to be realized from the operation of the other named facilities [R. 148-150, 155, 173, 180-181, 223-224]. All of the aforesaid was represented to the stockholder in a *pro forma* balance sheet [R. 179-181] and also was speedily abandoned.

Pursuant to said plan, the corporation was organized, and, on February 28, 1949, respondents Lordan, Brandsma, Browne, Langley and Dietrich were elected directors of the corporation; they also constituted the entire board of directors [R. 4, 90, 94, 101, 110, 114]; respondent Lordan was elected president of the corporation on the same date, and still holds that office [R. 114] respondent Brandsma was elected secretary-treasurer of the corporation on the same date, and held that office until November 17, 1950, when he was elected vice-president [R. 4, 90]. Respondent Ferrar became general business manager of the corporation on September 15, 1950, and still holds that office [R. 4, 105]; he became treasurer of the corporation on November 17, 1950, and became secretary of the corporation on or about November 12, 1952, and still holds those offices [R. 4-5, 105]. At all times since October 10, 1950, all of the individual respondents have been and they now are, members of the executive committee of the corporation; they comprise the entire executive committee [R. 5], in actual control. During the holiday season of 1949-1950, and in April, 1950 [R. 145, 203, 225-226], petitioner learned of the proposed corporation and its plans and purposes from respondents Lordan and Brandsma and from his son-in-law, a doctor [R. 145, 203-204, 225-226, 260-261] and, wishing to help provide for the Los Angeles area an outstanding medical

clinic in which his son-in-law could participate [R. 260-261] he, in about April, 1950, purchased 400 shares of the common stock of the corporation and loaned $20,000 in cash to the corporation [R. 3, 146, 204, 261]. This was the first cash the corporation had received and it gave the corporation some credit standing with the bank [R. 261].

Thereafter, during 1950 and 1951, the corporation acquired by purchase ten (10) lots, constituting a single parcel of ground in Beverly Hills, California, for a consideration of about $300,000 and constructed thereon a medical clinic building which occupied about three (3) lots [R. 6]; in 1951 it acquired by lease from Martha Lordan, wife of the respondent Lordan, an additional adjoining lot, hereinafter referred to as lot 761 [R. 6, 27], and in 1952 purchased said lot 761 for $35,000 [R. 6]. At considerable expense the corporation also graded, paved and equipped as a parking lot the unoccupied portion of its real estate, consisting of about eight (8) lots and including lot 761 [R. 6].

During 1951 the corporation completed the construction and equipping of its building, including a clinical laboratory, an X-ray laboratory, and a pharmacy and soda fountain, and leased the greater portion of the building, other than the above facilities, for use as a medical clinic, to a partnership of doctors under the control of the individual respondents doing business under the style "The Beverly Hills Clinic" [R. 6-7, 155].* The building was completed and The Beverly Hills Clinic commenced its operations on or about September 1, 1951

*The same executive committee dominated the corporation and the "partnership."

[R. 155, 177-178, 199, 200, 227]. The Beverly Hills Clinic (hereinafter for brevity sometimes called "The Clinic"), lessee of most of the corporation's building, was a co-partnership of doctors *and of one registered pharmacist,* respondent Ferrar [R. 5, 105, 224]; all of the individual respondents were members and general partners of, and financially interested in, The Clinic [R. 5, 90, 94, 101, 105, 110, 114]; neither petitioner nor the respondent corporation were members of or financially interested in, The Clinic [R. 5].

The partners in The Beverly Hills Clinic, including respondent Ferrar, own and hold 91% of the outstanding stock of the corporation; the six individual respondents, alone, own and hold 42.1% of said stock [R. 60-61]. Their dominant and complete control is obvious.

During 1951 and 1952 the individual respondents, as officers and directors of the corporation, caused the parking lot, the X-ray laboratory, and the clinical laboratory to be fraudulently diverted, as profit-making facilities, from the corporation to The Clinic, and thereby to themselves as members and general partners of The Clinic [R. 9-10, 16-17, 19, 20, 148-150, 173-174]. Such transactions were clearly fraudulent as to Petitioner and the corporation.

In May, 1952, while the corporation, under the terms of its lease from respondent Lordan, held a first right of refusal to purchase lot 761 [R. 28], the individual respondents fraudulently failed and refused to assert said right and permitted respondent John P. Lordan and his wife to sell said lot for $18,500 [R. 10, 17-18, 164, 167] and paid $500 of the corporation's funds to the new owners of lot 761 for an option to purchase said lot for $35,000 [R. 30-31], and several days later did in fact purchase

said lot 761 for the corporation for $35,000 on or about May 27, 1952, from the vendees of John and Martha Lordan [R. 10, 17-18, 66-67, 117-118].

In 1951 the individual respondents fraudulently and wrongfully caused and permitted the pharmacy operated within its building to be diverted, as a profit-making facility, from the corporation and to be placed under a so-called lease to respondent Ferrar with a remainder to respondent Lordan [R. 39-41]. Ferrar had agreed to operate it as an accommodation to, and for the use and benefit of, the corporation [R. 21-24, 149, 169-172]. Since about September 1, 1951, respondent Ferrar has been in possession of said pharmacy and has denied his trust and asserts that the profits from said pharmacy are his own [R. 24, 107-108]. After the corporation had been stripped of all of its profit-making facilities, as described above, the end result was that not only had it lost its expected profits but all of its income was derived from rent [R. 10-11, 148-150]; it became a personal holding company within the meaning of the Internal Revenue Code and subject to taxation as such [R. 11, 148, 150]; the corporate purposes were destroyed; and the majority stockholders voted to wind up and dissolve the corporation [R. 11, 128]. A minority, including petitioner, vigorously opposed this obvious corporate plunder.

In November, 1952, petitioner in Chicago, Illinois, received a telephone call from respondent Lordan in Los Angeles, California, telling petitioner of the appalling state of the corporation's affairs [R. 145, 236, 261]. Respondent Lordan then sent petitioner a letter dated November 13, 1952, confirming said telephone conversation [R. 146, 148-153, 236-237]. These transactions were the first information petitioner had received of the shocking manner

in which the corporation had been stripped of its income-producing facilities [R. 146, 261] and he immediately instituted an investigation into so much of the affairs of the corporation as was permitted by respondents [R. 147].

In early December, 1952, petitioner's attorneys commenced this investigation of the foregoing transactions [R. 9, 12, 125]. At about that time, petitioner's attorneys were informed by respondent Lordan that the Los Angeles law firm of Gibson, Dunn & Crutcher had been retained as legal counsel for the corporation [R. 12, 125, 135]. Thereafter, during December, 1952, and January, February and March, 1953, petitioner's attorneys made many demands and repeated efforts to inspect the books and records of respondents' corporation [R. 154] and to investigate the above transactions, but they were permitted to make only a limited inspection [R. 9, 11-16]. In mid-March, 1953, the attorneys for respondent corporation learned that petitioner had prepared and was about to file the instant suit against the respondents [R. 15, 133]; thereafter, on or about March 24, 1953, the attorneys for respondent corporation instigated and contrived a course of conduct [R. 134] to have respondents Brandsma, Browne, Langley and Dietrich resign as directors of the corporation and to choose and elect their own successors. This was done [R. 15-16, 134, 136]. Respondent Lordan remained a director and president of the corporation [R. 114], respondent Ferrar remained as secretary-treasurer and general business manager of the corporation [R. 105]. All of the individual respondents continued as members of the executive committee of the corporation and partnership [R. 5] and thus in complete control of both.

Having been unsuccessful in his efforts to obtain relief through the corporation [R. 9, 11-16] petitioner, on April 30, 1953, filed this action in the District Court [R. 2-45]. The law firm of Gibson, Dunn and Crutcher, from which petitioner's attorneys had been trying to secure vital information of the corporation's affairs for nearly four months. continued to represent defendant corporation until on or about May 4, 1953 [R. 142] opposing said suit; at all times herein mentioned they have represented, and do now represent, the individual respondents fraud feasors. On or about May 4, 1953, respondent corporation retained its present counsel, the law firm of Latham & Watkins [R. 142], apparently to show its "independence" of other respondents.

Respondent corporation and the individual respondents, on July 22, 1953, filed their separate but identical dilatory motions (1) to dismiss for failure to state a claim upon which relief can be granted [R. 46, 88] or (2) in the alternative, for a security bond pursuant to Section 834(b) of the California Corporations Code [R. 46, 88]. The individual respondents also moved to strike the complaint as sham, false, vexatious and frivolous [R. 88]. The question of jurisdiction over the subject matter based upon non diversity of citizenship *was never originally raised by the parties.* Said motions having been argued and submitted for decision the District Court, on December 10, 1953, made its order dismissing the case on the ground that it *probably* (*sic*) lacked jurisdiction over the subject matter of the action and hence lacked jurisdiction to entertain the motions [R. 253].

Thereafter, on December 23, 1953, respondent corporation and the individual respondents filed their separate motions (1) to dismiss the complaint for lack of jurisdiction over the subject matter of the action (2) and in

the alternative, renewing their previous motions [R. 254, 257]. Said motions were argued and submitted to the court on January 11, 1954, and the court then announced its decision that the motions to dismiss for lack of jurisdiction over the subject matter were granted, and on January 27, 1954, made and filed its Finding of Fact and Conclusions of Law [R. 264] and Judgment [R. 271].

The Court of Appeals affirmed the Order of Dismissal for lack of jurisdiction (App. B). The decision of the Court of Appeals is not yet reported.

Reasons for Granting the Writ.

(1) In holding that the respondent corporation should be realigned as a petitioner and thus destroy the jurisdiction of the United States District Court where proper *diversity* had been alleged, both the Court of Appeals and the District Judge below departed from established legal precedent and decided an important question of law in a manner directly in conflict with the established decisions of this Court in *New Jersey v. Mills,* 113 U. S. 249; *Railroad v. Grayson,* 119 U. S. 240; *Doctor v. Harrington,* 196 U. S. 579; *Venner v. Great Northern,* 209 U. S. 24, 31, 32; *Delaware & Hudson v. Albany & Susquehanna,* 213 U. S. 435, 451; *Indianapolis v. Chase Bank,* 314 U. S. 63; *Koster v. Lumbermen's Mutual,* 330 U. S. 518.

(2) The Court of Appeals decision is in conflict with established decisions of other Courts of Appeals, in the cases of: *Groel v. United Electric Co.* (C. C. N. J.), 132 Fed. 252; *Lavin v. Lavin* (2 Cir. 1950), 182 F. 2d 870; *Schmidt v. Esquire* (7 Cir. 1954), 210 F. 2d 908, leading Courts of Appeals throughout the United States.

Other decisions of this court which should control in the instant case, but which were ignored by both courts

below are: *Meyer v. Fleming*, 327 U. S. 161; *Greenwood v. Freight*, 105 U. S. 13; *East Tennessee R. Co. v. Grayson*, 119 U. S. 240. The Court of Appeals not only disregarded but actually flouted its own decision in *Cutting v. Woodward* (C. A. 9), 255 Fed. 633, 635. The case is so closely in point as to shock one's sense of Justice.

This is also the rule of decision of the California Supreme Court in *Wickersham v. Crittenden*, 106 Cal. 329, 331.

(3) The question presented by this petition for review on writ of certiorari is of tremendous social and legal importance. The decisions of the United States District Court for the Southern District of California in this case, and in the case of *Smith v. Sperling* (S. D. Cal. 1953), 117 Fed. Supp. 781, which were affirmed by the United States Court of Appeals for the Ninth Circuit, in this case on May 23, 1956 (No. 14,349, not yet reported), and in *Smith v. Sperling* (No. 14,334, not yet reported), on May 21, 1956, not only depart from the applicable decisions of this court, and conflict with the decisions of the various other courts of appeals, but they tend to establish a rule in the Ninth Circuit which will effectively close the doors of the federal courts to shareholders who are compelled to bring secondary or derivative actions in order to protect themselves from their own corporations, and who seek federal jurisdiction based upon diversity of citizenship. Unless these unfortunate decisions are reviewed and corrected the tens of thousands of persons who have invested in corporate shares will have lost one of the most effective of their few methods for compelling corporate management to respect its obligations of trust. With the filing of this petition both of said decisions are now pending before this court on Petition for Certiorari.

The Court of Appeals Opinion.

In affirming the District Court Order of Dismissal for lack of Jurisdiction of the Subject Matter, apparently for non-compliance with Rule 23(b) of the Rules of Civil Procedure, the Court of Appeals engaged in six page rationalization of its position which bears careful study by this court, particularly in light of its departure from established precedent. There is no room for dispute but that the Court of Appeals relied in chief upon the trial court's rulings of law and findings of fact and, insofar as legal precedent was concerned, upon its own and the District Court's erroneous ruling in the case of *Smith v. Sperling* (C. A. 9), No. 14334, ... F. 2d ..... (not yet reported), and *Smith v. Sperling,* 117 Fed. Supp. 781. No other legal precedent was cited.

Both the Court of Appeals and the District Court based its ruling on its *finding of fact* that the Beverly Hills Corporation was at the time of the Commencement of the Action possessed of an "independent volition" to prosecute its own suit, even though it had not done so; and had, in fact, actively opposed such action. All this in the face of a finding by the District Court, as alleged by Petitioner's Complaint that a demand had been made on the Corporation to join in the suit. Both the courts below based their ruling on the so-called "lawyer made" independent board of directors, who in fact were not independent, but upon whom no demands were made. Both the courts below found that such demand "would have been futile" [R. 266, 287].

Apart from the realities of the situation, the lower courts are reduced to the absurd position that petitioner's suit, although it is in classical compliance with Rule 23(b), is defeated for lack of jurisdiction because a "futile de-

mand" was not made on an "independent directorate," who in fact, in this case have actively and vigorously opposed the instant suit to recover for the fraudulent losses inflicted by the individual defendants-respondents, who selected their "independent successor directors" to carry on the fight to defeat the suit for the Corporation's benefit, and so far have done an excellent job of defeating "independent" corporation rights against the individual respondents.

If there is anything left of "fireside justice," it should be applied to these respondents with a strait jacket. By way of repetition, it should be pointed out that the rulings below were in no way based upon an alleged failure of petitioner to comply with the requirements of Rule 23(b). The verified complaint alleged, and the District Court found that the petitioner was a shareholder at the time of the transactions complained of [R. 3, 265, 286], that the action was not a collusive one to confer on the District Court jurisdiction of any action of which it would not otherwise have jurisdiction [R. 3, 267, 287], and that it would have been futile for petitioner to make further demands upon the Corporation for relief [R. 11-16, 266, 287], in view of his previous efforts as alleged with particularity in the Complaint [R. 11-16], the ruling of the courts below seem absurd.

Absent collusion, the instant complaint was one which clearly conferred jurisdiction in the District Court; and it was only by the subterfuge of "trial by affidavit"—which at most contradicted the sworn complaint that the courts below were able to "manufacture" the argument that the Respondent Corporation could be re-aligned as a plaintiff in a suit for its benefit, but which it was nonetheless opposing in union with the alleged fraudulent in-

dividual defendant-respondents. It is fundamental that a corporation can act only through its directors and officers; but when the directors and officers fail or refuse to act, or as here oppose such action, then the corporation as a practical matter is incapacitated from acting. (*Groel v. United Electric* (C. C. N. J.), 132 Fed. 252, 262.)

The courts findings below, that the Respondent Corporation could act independently to protect its rights against the individual respondents, and at the same time it would be futile to make a demand on it and protect its rights by suit, are two wholly inconsistent findings. The Respondent Corporation's opposition to the suit for its own benefit most cogently reveals its true position as a defendant, and not a plaintiff.

Conclusions.

For the foregoing reasons, this petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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